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No. 02-1746

Supreme Court, U.S.
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In The
Supreme Court of the United States

SANDWICH CHEF OF TEXAS, INC.
D/B/A WALL STREET DELI,

Petitioner,

v.

RELIANCE NATIONAL INDEMNITY COMPANY, *et al.*,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

PETITIONER'S REPLY MEMORANDUM

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PETITIONER'S REPLY MEMORANDUM

By imposing new causation requirements, the Fifth Circuit has eliminated RICO as a weapon for combating insurance frauds that involve deceptions practiced on state regulators. Pet. 9. The Fifth Circuit has also placed itself squarely in conflict with other circuits that reject these requirements. Because of RICO's singular importance and because the circuits' splits relating to causation are well developed, this Court should re-visit the issue, which it last touched in *Holmes v. Sec. Investor Prot. Corp.*, 503 U.S. 258 (1992).

The Court should also use this case to reaffirm the application of due process and the evidence rules to class certification decisions. The Fifth Circuit created uncertainty about both by relying on non-evidence when finding the crucial "fact" supporting its decision, even though Wall Street had no notice that non-evidence would be used. Thousands of class actions are filed in federal courts every year.[1] Judges and parties need to know whether due process principles and the Federal Rules of Evidence govern certification decisions.

A. The Court should grant certiorari to resolve conflicts over RICO fraud causation.

1. *Proximate cause versus reliance. Holmes* requires a RICO fraud plaintiff to establish proximate cause. 503 U.S. at 268. Purporting to apply *Holmes*, the Fifth Circuit holds that "'RICO fraud liability requires a showing of reliance by *each plaintiff*.'" App. 22 (emphasis in original) (*quoting Bolin v. Sears, Roebuck & Co.*, 231 F.3d 970, 978 (5th Cir. 2000)). The Second, Fourth, Sixth, and Eleventh

[1] *See* Federal Judicial Center, Effects of *Amchem/Ortiz* on the Filing of Federal Class Actions: Report to the Advisory Committee on Civil Rules (Sept. 9, 2002).

Circuits also require reliance. Pet. 12-13. In sharp contrast, the First, Third, Seventh, Eighth, and Ninth Circuits, also purporting to apply *Holmes*, reject reliance. *See, e.g., Sys. Mgmt., Inc. v. Loiselle*, 303 F.3d 100, 104 (1st Cir. 2002) ("There is no good reason here to depart from RICO's literal language by importing a reliance requirement into RICO."); Pet. 12, 14-15. Proximate cause courts allow class actions to proceed whenever common evidence shows a direct connection between class members' losses and a fraud. Pet. 14-15. Reliance courts generally prohibit class actions on the ground that reliance requires individualized proof. District courts in the Fifth Circuit no longer have discretion to certify RICO fraud cases.[2]

The schism over reliance goes to the heart of RICO's purpose. In the Seventh Circuit, district courts "focus[ ] on the defendant's conduct in devising or intending to devise a scheme to defraud, not the individual experiences of each defrauded person." *Peterson v. H & R Block Tax Servs., Inc.*, 174 F.R.D. 78, 84 (N.D. Ill. 1997); *Heastie v. Cmty. Bank of Greater Peoria*, 125 F.R.D. 669, 674-75 (N.D. Ill. 1989) ("variations in individual reliance do not defeat certification"). The Fifth Circuit's reliance requirement leads to exactly the opposite result. Under the reliance standard, the court's entire focus is on the experience of each plaintiff. As a result, the court entirely ignores the overarching RICO scheme.

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[2] *Gyarmathy & Assoc., Inc. v. TIG Ins. Co.*, No. CIV. A. 3:02-CV-1245, 2003 WL 21339279, at *2 (N.D. Tex. Jun. 3, 2003) (denying certification and quoting *Richard v. Hoechst Celanese Chem. Group, Inc.*, 208 F.R.D. 575, 584 (E.D. Tex. 2002), that RICO fraud class actions "may not be possible"). *See also* Michael Goldsmith & Evan S. Tilton, *Proximate Cause In Civil Racketeering Cases: The Misplaced Role of Victim Reliance*, 59 WASH. & LEE L. REV. 83, 104 n.106 (2002) (observing that "recent appellate decisions" make "the reliance requirement in RICO [fraud] litigation an insuperable barrier to class certification," *citing Patterson v. Mobil Oil Corp.*, 241 F.3d 417, 419 (5th Cir. 2001); *Bolin*, 231 F.3d at 978-79).

In this case, the Fifth Circuit adopted a reliance-based "working presumption" against RICO fraud class actions. App. 23. The presumption has evidentiary force: it enabled Respondents to decertify the class by asserting a fact (widespread knowledge that actual charges exceeded filed rates) they could not prove.[3] Wall Street attacked the "working presumption" vigorously in its petition. Respondents offered no reply. The phrase "working presumption" is not in their brief.

In the Seventh Circuit and others that require only proximate cause, this case would proceed as a class action. Common evidence clearly shows that policyholders were the direct, intended, and sole victims of Respondents' scheme. In other words, common evidence establishes a "direct relation between the injury asserted and the injurious conduct alleged." *Holmes*, 503 U.S. at 268. Under the reliance requirement, however, the class action founders on the shoals of individual proof. This Court's decision as to whether reliance either is, or is not, required to show proximate cause in a RICO fraud case will determine whether the district court's certification order was proper.[4]

2. *Proximate cause versus convergence and contemporaneousness.* Circuits that require reliance often require convergence. Convergence exists when the person who lost money is also the person deceived. The Fifth, Sixth, and Eleventh Circuits require convergence. Pet. 13-14. The First, Second, Third, Fourth, Seventh, Eighth, and D.C.

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[3] Respondents found one policyholder in the nation that *did know* a regulator would be deceived, Environmental Resources Management ("ERM"). Resp. 9. However, ERM did not have an Option V policy and it is not a class member. Its policy covers a California risk, and California does not allow Option V policies. R43:84:11-14, 87:6-21; PXCH124:116-17.

[4] Contrary to Respondents' statement, Resp. 19, Wall Street maintained before the Fifth Circuit that policyholders should prevail without having to prove reliance. Br. of Appellee 34-36. It argued that payment of the invoices is proof of proximate cause that cannot be defeated by a policyholder's limited knowledge of the rate it paid. *Id.* 36-47.

Circuits do not, allowing RICO fraud suits to proceed when the defendant harms the intended victim by deceiving a third party, such as a regulator empowered to protect the victim. Pet. 13.

The Fifth Circuit established a convergence requirement when it amended *Holmes*'s "direct[] injury" requirement, 503 U.S. at 274, and held that a RICO plaintiff's injury must be "direct *and contemporaneous*." App. 31-33 (emphasis added). The Fifth Circuit plucked the *contemporaneousness* requirement from thin air. Neither *Holmes* nor any other case mentions it. Respondents do not contend otherwise. They did not respond to Wall Street's attack on the contemporaneous requirement. Pet. 19-22. The word "contemporaneous" does not appear in their brief, even though the Fifth Circuit used the phrase "direct and contemporaneous" *eight times*. App. 31-33.

The contemporaneous requirement requires convergence because a defendant's deception and a plaintiff's injury are contemporaneous only when the victim is the person deceived. A defendant's deception of a third party, such as a regulator, is always separated by time and events from the targeted victim's injury. Like reliance, convergence greatly narrows RICO's reach.

Respondents say "no court has ever found that a misrepresentation made to a third party was the proximate cause of a plaintiff's injury if the plaintiff knew of the misrepresentation and had an opportunity to use that knowledge to avoid the injury." Resp. 21. This is untrue. Even the Fifth Circuit found causation in such situations until it decided this case.[5] Respondents support their

[5] In *Proctor & Gamble Co. v. Amway Corp.*, 242 F.3d 539 (5th Cir. 2001), P&G (the target) knew that Amway's defamatory statements to consumers (the third parties) were false and actively sought to avoid injury by countering them. *Proctor & Gamble*, 242 F.3d at 564-65. The Fifth Circuit held that P&G could show proximate cause. *Id.* In the present case, the Fifth Circuit cut off the target wing that it recognized in *Proctor & Gamble* when it held that the "district court erred in

(Continued on following page)

assertion that knowledge always defeats fraud by citing the Fifth Circuit's decision in *Summit Props. Inc. v. Hoechst Celanese Corp.*, 214 F.3d 556, 562 (5th Cir. 2000). Yet, Respondents do not respond to Wall Street's observation that *Summit* and *Sebago v. Beazer E., Inc.*, 18 F. Supp.2d 70, 83 (D. Mass. 1998), reach exactly opposite results. Pet. 16-17. Under *Sebago*, a victim's knowledge is not relevant when a deception practiced on a third party causes its injury. *Id.* at 83-84.[6]

Whether convergence is required or not determines the continued viability of this and no other class actions. It is undisputed that Respondents deceived regulators because they wanted to overcharge policyholders and that regulators would have protected policyholders had they not been deceived. App. 33, 63. Common evidence will support a recovery for all class members if the convergence requirement is removed.

3. *The reliance and convergence requirements defeat RICO's purpose.* The Court should grant certiorari because the Fifth Circuit's use of the common-law doctrines of reliance and convergence defeats RICO's purpose. The Fifth Circuit held that if a policyholder "negotiated a premium that varied from the filed rate [and] was aware

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concluding that the target theory could be invoked to excuse proof of individual reliance on fraudulent predicate acts." App. 28. P&G neither received Amway's false statements nor relied on them. The Fifth Circuit plainly changed the law when it decided this case, a fact the respondents fail to address.

[6] The holding in *Sebago* is the law of the First Circuit. *See Loiselle*, 303 F.3d at 104. *Loiselle* directly contradicts the decision below. Loiselle's workers were allowed to sue under RICO even though they willingly accepted wages below the statutory minimum. They "received what they thought was . . . a good wage (though, by law and by contract, not good enough)." *Sys. Mgmt., Inc. v. Loiselle*, 112 F. Supp.2d 112. 119 (D. Mass. 2000). Here, the policyholders agreed to pay what they thought were the lowest rates they could get. They can still sue under RICO, however, because under all states' laws, their charges were too high.

that the insurer was charging more than what regulators had approved," then the policyholder "was not a victim of fraud." App. 34. This knowledge defeats causation, according to the Fifth Circuit, even if the policyholder knew nothing of Respondents' scheme to deceive regulators, was legally required to obtain workers' compensation insurance, was powerless to defeat the fraud by obtaining a lawful rate, and would have been protected by regulators had the fraud been revealed.[7] This shows quite clearly that, in circuits that require reliance or convergence, RICO is a toothless Act. Successful conspirators may commit mail and wire fraud at will if victims have some information.

In other circuits, a victim can know about the entirety of a defendant's fraud, but be powerless to avoid injury and still maintain a RICO claim. Many courts have allowed victims of racketeering to assert claims based on lies to third parties, even though the victims knew of the fraud and sought to avoid injury. *See, e.g., Shaw v. Rolex Watch U.S.A, Inc.,* 726 F. Supp. 969, 972-73 (S.D.N.Y. 1989) (noting that some courts explicitly reject the need for the intended victim to show detrimental reliance on mailed misrepresentations and holding plaintiff who was the intended target was not barred by his knowledge of the fraud).

Wall Street's petition argued that the reliance and convergence requirements frustrate private RICO fraud suits that serve important public purposes. Pet. 22-23. To deny policyholders relief on such common-law grounds defeats RICO's public policy of "root[ing] out public

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[7] Wall Street accuses Respondents of violating RICO by (1) using NCCI to deceive state insurance regulators, (2) excluding insurance at lawful rates from the market, and (3) failing to disclose that bills were unauthorized and thus unlawful. Respondents never address the first or second allegation, and they do not address the third allegation squarely. Instead of focusing on the time Respondents sent inflated bills, they discuss negotiations that occurred 18 months before. These conversations have no bearing on the fraud alleged because Respondents were required to obtain approval from regulators *after* negotiations ended and *before* billing. Pet. 22-23.

corruption." Pet. 22 (*citing Bieter Co. v. Blomquist*, 848 F. Supp. 1446, 1449-50 (D. Minn. 1994)). Only claimants who are *in pari delicto* with conspirators under the strict test of *Bateman Eichler* should be barred from suing under RICO.[8] Knowledge of injury should neither preclude a victim from RICO relief nor create a defense. Here the district court expressly found "no evidence" that any policyholder was *in pari delicto* with Respondents.[9] Respondents never challenged this finding and the Fifth Circuit left it intact so it is binding. *See Glover v. United States*, 531 U.S. 198, 205 (1995). Common evidence proves the RICO case because, given that no policyholder is *in pari delicto* with Respondents, policyholders' knowledge of rates they paid is irrelevant. Pet. 22-23. Respondents did not address this argument in their response.

Respondents offered no evidence that any policyholder knowingly paid more than the law allowed. As explained below, the Fifth Circuit based this "fact" on non-evidence. Even so, this Court should find that the hypothetical policyholder invented by the Fifth Circuit is entitled to sue. All policyholders were victimized by a conspiracy, and none was *in pari delicto* with Respondents. Pet. i, 22-23.

By removing the common-law barriers that the Fifth Circuit and others have erected, this Court will permit the

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[8] In *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985), the Court set the test for *in pari delicto* as follows: "[A] private action for damages . . . may be barred on the grounds of plaintiff's own culpability only where (1) as a direct result of his own actions, the plaintiff bears at least substantially equal responsibility for the violations he seeks to redress, and (2) preclusion of suit would not significantly interfere with the effective enforcement of the securities laws and protection of the investing public." This test applies to RICO. *See Bieter*, 848 F. Supp. at 1449-50.

[9] "No evidence of any class member's involvement in the alleged scheme was presented . . . in the certification hearing. [Respondents] do not argue that any class member participated in the alleged scheme to corrupt NCCI, to make false rate filings or to prepare deceitful invoices." App. 76.

private enforcement of RICO as intended by Congress.[10] But no matter the result on the merits, the conflicts among the circuits on RICO fraud causation should be resolved.

B. The Court should grant certiorari to ensure the uniform application of the Federal Rules of Evidence consistent with due process.

Due process requires judges to ignore non-evidence when finding facts, Pet. 26, and the evidence rules govern all "proceedings" in federal courts. FED. R. EVID. 101. The Fifth Circuit based its decision to reverse on a fact that it found based only on *non*-evidence. The need to review its decision is urgent, both because the decision conflicts with prior decisions of this Court and because it contravenes FED. R. EVID. 101. This Court, as the final arbiter of the various sets of Federal Rules, is the administrator of their consistent and proper application.[11] In the Rules Enabling Act, Congress authorized this Court to prescribe uniform Rules to govern the "practice and procedure" of the federal district courts and courts of appeals. 28 U.S.C. § 2072. Here, it should determine whether due process and the evidence rules apply to class certification decisions.[12]

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[10] RICO is to be liberally construed to effectuate its remedial purpose. *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 497-98 (1985).

[11] *See, e.g., Celotex Corp. v. Catrett*, 477 U.S. 317 (1986); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242 (1986); *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986) (correcting the circuit court's erroneous interpretations of FED. R. CIV. P. 56).

[12] Respondents never address the Fifth Circuit's anti-class action agenda. Pet. 11 n.6. The Fifth Circuit has continued this trend. *See, e.g., Bell Atl. Corp. v. AT&T Corp.*, No. 02-40656, 2003 WL 21660126 (5th Cir. Jul. 16, 2003) (affirming denial of certification); *Pedcor Mgmt. Co., Inc. Welfare Benefit Plan v. Nations Pers. of Texas, Inc.*, No. 02-20878, 2003 WL 21927036 (5th Cir. Aug. 13, 2003) (reversing certification).

Respondents admit due process violations occurred. First, they admit the district court ordered and held an "evidentiary" hearing *at their insistence*. Resp. 11. Second, they cite no authority allowing a judge to consider non-evidence after an evidentiary hearing concludes.[13] Third, they agree the Fifth Circuit's decision rests entirely on materials Respondents failed to put in evidence. Resp. 12 n.11. Finally, the class certification hearing was a "proceeding," so the Rules of Evidence governed and the Fifth Circuit's decision to rely on non-evidence was arbitrary. Respondents controvert *none* of this.

Respondents say "there is no rule requiring that class-certification determinations be made on a formal evidentiary record." Resp. 12. However, they neither mention FED. R. EVID. 101 nor explain it away. Respondents also miss the due process point: even if the district court initially had discretion to consider non-evidence (it did not), its discretion disappeared once it ordered and held an evidentiary hearing. The parties had no notice that the court would consider non-evidence, so the court had to ignore non-evidence.

Respondents then contend that "even if the record were limited to evidence formally admitted during the class-certification hearing," the Fifth Circuit should be

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[13] Respondents argue that Wall Street's cases are irrelevant because they involve decisions on the merits. Resp. 29-30. This Court has recognized the importance of ensuring the application of due process principles to procedural decisions in class actions. *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 799 (1985) ("We granted certiorari to consider" the claim that "the Due Process Clause of the Fourteenth Amendment prevented" Kansas from asserting personal jurisdiction over non-resident class members). The aim of due process – discouraging arbitrary exercises of judicial power – applies fully to procedural decisions, as this Court's many decisions on personal jurisdiction show. Moreover, the Fifth Circuit's decision to deny certification has substantive implications. The district court expressly found that many class members have claims that are too small to justify the cost of litigation. The Fifth Circuit's decision extinguishes thousands of claims.

upheld because (1) it made no factual finding but instead (2) "'relied on evidence' . . . [showing] that critical questions of fact specific to individual class members would need to be resolved at trial." Resp. 29. Statement (2) contradicts statement (1). *Courts only rely on evidence when finding facts.* The trial court found "no evidence" showing a need to try individual issues, but the Fifth Circuit, relying solely on non-evidence, found the reverse. The Fifth Circuit found a new "fact" not supported by admitted evidence that was evaluated in open court. Because it held neither that the district court wrongly excluded any materials nor that any of the district court's factual findings were clearly erroneous, it unlawfully usurped the district court's role.

Attempting to retry the case they lost in the district court, Respondents further prove the due process violations. Respondents cite an expert report by Scott Harrington *17 times*. *See* Resp. 2-6, 9 (citing SR307:App.1,5).[14] The Fifth Circuit relied on the report when reversing because the district court had not "explicitly excluded" it from evidence. App. 17 n.6. Yet Respondents *never* offered Harrington's report as evidence. Consequently, Wall Street had no opportunity to object to it or to rebut it, and the district court had no opportunity to explicitly exclude it. The Fifth Circuit's abrogation of FED. R. EVID. 101 undermines due process by denying the parties notice of the evidence that will be considered.

This clear due process violation warrants summary reversal. Alternatively, this Court should grant the petition and eliminate the confusion created by the Fifth Circuit's use of non-evidence to find facts.

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[14] All of Respondents' 27 citations to "SR307" are materials that the district court did not admit in evidence. Wall Street cannot address Respondents' many distortions here. Fortunately, there is no need. The Fifth Circuit left all the district court's factual findings intact. The district court's unchallenged "no evidence" finding shows that policyholders have no knowledge sufficient to negate the causation.

Respectfully submitted,

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